

H.R. 238 – Commodity End-User Relief Act (Rep. Conaway, R-TX)

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FLOOR SCHEDULE:

Expected to be considered on January 12, 2017 under a structured rule.

TOPLINE SUMMARY:

<u>H.R. 238</u> would authorize appropriations for the <u>Commodity Futures Trading Commission</u> (CFTC) through 2021, and would provide enhanced protections for futures customers.

COST:

A Congressional Budget Office (CBO) estimate is not yet available.

CONSERVATIVE CONCERNS:

There are no substantive concerns.

- Expand the Size and Scope of the Federal Government? No.
- Encroach into State or Local Authority? No.
- Delegate Any Legislative Authority to the Executive Branch? No.
- Contain Earmarks/Limited Tax Benefits/Limited Tariff Benefits? No.

DETAILED SUMMARY AND ANALYSIS:

This bill would seek to protect customers from certain market failures such as in cases like MF Global and Peregrine Financial scandals, and from certain regulations implemented after the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Public Law 111-203) that the CFTC is tasked with implementing. The CFTC was last authorized in the Food, Conservation, and Energy Act of 2008.

Title I would provide protections to end-users who use the futures-markets, by requiring several customer protections including:

- Requiring members of registered futures associations to maintain policies pertaining to the
 maintenance of cleared swaps collateral accounts, residual interest in segregated accounts, and
 secured amount funds in foreign futures and options customer accounts.
- Requiring members of registered futures associations to create rules for withdrawal, transfer, or disbursement by a futures commission merchant (FCM) of the above funds.
- Requiring FCMs to use electronic confirmation of customer fund account balances at depository institutions, and to report balances to the National Futures Association (NFA).
- Requiring firms to report to the CFTC and a self-regulatory organization (SRO) immediately if they
 become under-capitalized, so that CFTC and the SRO can assess the FCM's viability, and take any
 needed action to protect customer funds.

- Requiring a firm's chief compliance officer to submit a yearly assessment of its internal compliance programs to the CFTC.
- Allowing futures customers, including farmers and ranchers, one full business day following a trade to comply with the amount of money, securities, and property required for their margin to an FCM.
- Providing a framework and clarity for futures customers, so that the assets of a bankrupt commodity broker could be used to pay back misappropriated or illegally transferred customer segregated funds, or any deficient public customer account.

Title II would reauthorize the CFTC, and provide a number of reforms to the commission including:

- Authorizing appropriations of \$250 million to the CFTC from FY17-FY21.
- Establishing the Office of the Chief Economist (OCE), also answerable to the entirety of the CFTC, to provide economic data and analysis.
- Modifying the CFTC's cost-benefit analysis requirement under the <u>Commodity Exchange Act</u> for proposed rules, to be consistent with those found in <u>President Obama's Executive Order 13563</u> for the executive branch. The cost-benefit analysis would be required to be performed by the chief economist, and published along with the proposed rule, with justification. The administration's implementation of EO 13563 has been mixed.
- Clarifying that each CFTC division director must be answerable to the entirety of the CFTC, not solely the chairman.
- Requiring the CFTC to establish an internal procedure pertaining to the issuance of responses to formal guidance petitions or in response to no-action, interpretive, or exemptive letters. Commissioners would receive the final version in advance for review, prior to issuance.
- Requiring the commission to create a strategic technology plan every 5 years. The plan must include details on market surveillance, risk detection, and an accounting of how funds will be used.
- Requiring the CFTC and the chief economist to develop internal risk control mechanisms, for the purposes of safeguarding market data.
- Ensuring commissioners have a say, through a commission vote, in approving omnibus orders of investigation, which authorize the issuance of subpoenas. Orders for investigation would have a finite period, and would be subject to commissioner vote for renewal.
- Requiring notice and comment provisions of the Administrative Procedures Act to apply to guidance and policy statements that prescribe law or policy, and that are issued by and voted on by the CFTC.
- Providing original jurisdiction over the review of CFTC issued final rules to the United States Court
 of Appeals for the District of Colombia, or the U.S. Court of Appeals for the circuit in which the party
 resides, creating a similar judicial review process to that of the Securities and Exchange
 Commission. It would ensure that both regulators that are responsible for oversight over the
 derivatives market have similar procedures for judicial review.
- Requiring the Government Accountability Office (GAO) to conduct a study on CFTC resources, and examine whether they are sufficient, in addition to looking at prior expenditures of funds on market surveillance and market data collection. The study would look at whether SROs could be used more effectively, and what impact risk reduction services have on oversight.
- Requiring clarity for determining when the CFTC can disclose proprietary information on CPO-PQR
 and CTA-PR forms. The information could be disclosed to Congress, but to no other entity federal or
 foreign, without a confidentiality agreement.

Title III would address the commission's response to Dodd-Frank. According the committee in the past, the CFTC has narrowly interpreted the law, which has threatened the ability of producers to affordably protect against risks associated with farming and ranching. The CFTC has finalized dozens of rules to enforce the Dodd-Frank Act, and has issued numerous "no-action" letters to delay, revise, or exempt application of these regulations upon various market participants. The rulemaking process has proven confusing given the lack of a comprehensive plan for setting a schedule for compliance. This Title would:

- Ensure that commercial end-users should not be classified and treated like banks, and the bill fixes
 the definition of "financial entity" to ensure that they are not. Defines a commercial market
 participant.
- Create a new category within the definition of "swap dealer," for transactions in utility-operations swaps, which would be reported in the same manner as un-cleared swaps, and excluded from the entity's general *de minimis* calculation.
- Define a "utility special entity" as an entity established by a state or subdivision, that (1) owns/operates, or anticipates doing so, an electric or natural gas operation, (2) supplies or anticipates supplying, natural gas, electric energy, or another utility special entity; (3) has or anticipates having public service obligations to deliver electric energy or natural gas; or, (4) is a Federal power marketing agency.
- Define a list of "commonly known" transactions, to also describe utility operations-related swaps, and further defines "utility operations-related swaps."
- Require the CFTC to promulgate a rule to delay public reporting on non-cleared swaps traded in an illiquid market by a non-financial entity to at least 30 days after the transaction. Defines an illiquid market.
- Reduce reporting requirement for grain elevators, farmers, agriculture counterparties, and
 commercial market participants that require the recording of all forms of communication that may
 possibly lead to a trade. The bill would specify that keeping written records of the final material
 economic terms of an agreement will be sufficient for market participants who are only managing
 their own money.
- Clarify that contracts that contain an option to change the amount of a commodity delivered, but result in actual physical delivery of a commodity should not be regulated as swaps. This impacts utilities that use natural gas to produce electricity, in addition to millions of consumers who use natural gas to heat their homes.
- Require a vote on a new regulation to change the current *de minimis* threshold after the commission completes a planned study on the issue. The Dodd-Frank Act provides an exemption for a person who "engages in a *de minimis* quantity of swap dealing in connection with transactions with or on behalf of its customers." On December 31, 2017, the *de minimis* exception from the swap dealer definition will be reduced by \$5 billion.
- Ensure that non-bank swap dealers should not be required to hold exponentially more capital than their bank counterparts. This bill would ensure that swap dealers without a prudential regulator would be able to use workable capital requirement formulas.
- Make conforming changes regarding advertisement for participation in commodity pools so that they are in line with the IOBS Act.
- Ensure that end-users' ability to hedge against anticipated business risks should not be limited by the CFTC's arbitrary narrowing of acceptable hedging activities. The bill would provide a more workable definition of bona fide hedging as it relates to position limits.
- Require the CFTC to put in place a comprehensive plan for how to address the international nature
 of swaps trading and to determine how to share regulatory obligations over transactions that cross
 international boundaries.
- Exempt qualified charitable organizations from the definition of "commodity pool."
- Clarify that CFTC decisions that exempt small banks and savings associations from classifications as financial entities will also be extended to the holding companies of said banks and associations if the consolidated assets of the holding company do not exceed the asset threshold set by the CFTC.
- Narrow a SEC's responsibility to monitor "trading in swaps" to swaps trading only on its own facility, and to give them flexibility in surveillance and monitoring rules. It also modifies the duties of a SEC chief compliance officer and annual reporting procedures.
- Include the Federal Housing Finance Agency for a Federal Home Loan Bank, in defining "appropriate federal banking agency. This change would clarify that any advance made to financial institutions by Federal Home Loan Banks are banking products, and not derivatives.



• Exclude investment advisors from the definition of commodity pool operator, if their company is registered with the SEC and only participates in or offers trading advice on financial derivatives.

Title IV provides for technical corrections.

A past RSC legislative bulletin can be found <u>here</u>.

A section-by-section from the Agriculture Committee can be found here.

GLOSSARY:

- Swap: In general, the exchange of one asset or liability for a similar asset or liability for the purpose of lengthening or shortening maturities, or otherwise shifting risks. This may entail selling one securities issue and buying another in foreign currency; it may entail buying a currency on the spot market and simultaneously selling it forward. Swaps also may involve exchanging income flows; for example, exchanging the fixed rate coupon stream of a bond for a variable rate payment stream, or vice versa, while not swapping the principal component of the bond. Swaps are generally traded over-the-counter.
- <u>Swap Dealer</u>: An entity such as a bank or investment bank that markets swaps to end users. Swap dealers often hedge their swap positions in futures markets.
- **Commodity Swap**: A swap in which the payout to at least one counterparty is based on the price of a commodity or the level of a commodity index.
- Commodity: (1) A commodity, as defined in the Commodity Exchange Act, includes the agricultural commodities enumerated in Section 1a(4) of the Commodity Exchange Act, 7 USC 1a(4), and all other goods and articles, except onions as provided in Public Law 85-839 (7 USC 13-1), a 1958 law that banned futures trading in onions, and all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in; (2). A physical commodity such as an agricultural product or a natural resource as opposed to a financial instrument such as a currency or interest rate.
- Derivative: A financial instrument, traded on or off an exchange, the price of which is directly dependent upon (i.e., "derived from") the value of one or more underlying securities, equity indices, debt instruments, commodities, other derivative instruments, or any agreed upon pricing index or arrangement (e.g., the movement over time of the Consumer Price Index or freight rates). They are used to hedge risk or to exchange a floating rate of return for fixed rate of return. Derivatives include futures, options, and swaps. For example, futures contracts are derivatives of the physical contract and options on futures are derivatives of futures contracts.

AMENDMENTS:

- 1. Rep. Aderholt (R-AL) This amendment would give the CFTC authority to designate other agencies to manage its leases.
- 2. Rep. Scott (R-GA) This amendment would reform the Consumer Protection Fund, amending its size and expenditures, and stipulating that any excess balance must be returned to the Treasury.
- 3. Rep. Conaway (R-TX) This amendment would clarify Congressional intent that the CFTC may impose position limits as necessary, if a finding has been made, without making changes to the longstanding federal position limits regime for enumerated agricultural commodities.
- 4. Rep Conaway (R-TX) This amendment would make technical and conforming corrections to the legislation.
- 5. Rep. Duffy (R-WI), Rep. Scott (D-GA) This amendment would prohibit the CFTC from compelling the production of algorithmic trading source code, or anything similar, without an issued subpoena.



- 6. Rep. LaMalfa (R-CA) This amendment would prevent situations in which end-users lose their exception to the clearing requirement because of positive transactions entered into to mitigate a potential decrease in revenues.
- 7. Rep. Lucas (R-OK) This amendment would exempt all inter-affiliate transactions from being regulated as swaps under Dodd-Frank related portions of either the CEA or CFTC regulations.
- 8. Rep. Hartzler (R-MO) This amendment would delay the implementation of the CFTC Ownership and Control Reports Rule until the Chairman has determined the rules has been amended to reflect adjusted reported trading volume levels of 300 contracts per day. It would also require the removal of the requirements for natural person controller data and would ensure the rule does not require entities to violate foreign privacy laws.

COMMITTEE ACTION:

H.R. 238 was introduced on January 4, 2017, and referred to the House Committees on Agriculture and Financial Services.

ADMINISTRATION POSITION:

A Statement of Administration Policy is not yet available.

CONSTITUTIONAL AUTHORITY:

Congress has the power to enact this legislation pursuant to the following: Article 1, Section 8, Clause 3, Congress has the authority to regulate foreign and interstate commerce.

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